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USOECD

USEEC

PASS TREASURY FOR UNDER SECRETARY SOLOMON, FRB FOR
GOVERNOR WALLICH

EO 11652: GDS
TAGS: OECD EFIN ECON CA FR GW IT JA NL SW SZ UK
SUBJECT: WORKING PARTY 3 OF EPC MEETING OF NOVEMBER 23

REF: (A) PARIS 34287, (B) STATE 264820

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SUMMARY

1. WP-3 MEETING WAS DEVOTED LARGELY TO DISCUSSION OF
THE CAUSES AND IMPLICATIONS OF THE CURRENT ACCOUNT
POSITIONS AND OUTLOOK OF THE BIG THREE -- U.S.,
GERMANY, AND JAPAN. U.K. AND SOME OTHERS RECEIVED
PASSING ATTENTION. THE MORNING WAS DEVOTED THE US.

THE GENERAL OPINION WHICH EMERGED WAS IN AGREEMENT WITH U.S. (BERGSTEN) VIEW THAT WE SHOULD EMPHASIZE ENERGY POLICY, BUT NOT CUT GROWTH OR DEPRECIATE THE DOLLAR TO REDUCE THE DEFICIT. THERE WAS WIDER DIVERGENCE OF VIEWS ON THE QUESTION F WHETHER FINANCING OF SUCH A LARGE DEFICIT COULD CONTINUE WITHOUT FURTHER EXCHANGE MARKET INSTABILITY AND DOWNWARD PRESSURE ON THE DOLLAR, UNLESS US MONETARY POLICY WERE TIGHTENED.

2. THE GERMAN REPRESENTATIVES ESSENTIALLY REPEATED EPC POSITION THAT FRG HAS DONE ALL IT COULD TO STIMULATE ECONOMY. AT THE SAME TIME THEY POINTEDLY ARGUED THAT GERMANY SHOULD NOT BE PUT IN THE SAME CATEGORY AS JAPAN. OTHER EUROPEANS, MOST SPECIFICALLY THE FRENCH, EMPHASIZED THE IMPORTANCE OF GERMAN GROWTH TO THEIR OWN PROSPECTS.

3. THE JAPANESE PROJECTED A REDUCED CURRENT ACCOUNT SURPLUS FOR 1978, CITING SLOWER MARKET GROWTH AND EFFECTS OF APPRECIATION. WP-3 DISCUSSION PROBED THE 30 PERCENT DEFICIT "BARRIER" TO FURTHER FISCAL STIMULUS, AND THE IMPLICATIONS OF IMPOR STRUCTURE FOR SPEED OF ADJUSTMENT. THE STRUCTURAL NATURE OF THE JAPANESE PROBLEM WAS NOTED, BUT WP-3 EMPHASIZED THAT NECESSITY OF REDUCING THE CURRENT ACCOUNT SURPLUS MEANS THAT ADJUSTMENTS -- OR CONTINUED EXCHANGE RATE APPRECIATION -- MUST OCCUR. THE SAME POINT WAS MADE FOR
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GERMANY.

4. THE UK REPRESENTATIVE NOTED THAT CONTROL OVER MONEY SUPPLY WAS CENTRAL CONSIDERATION IN POLICY OF ADHERENCE TO IMF STANDBY CONDITIONS AND IN "UNPEGGING" OF STERLING. HE ALSO INDICATED THAT SEVERAL FACTORS, NOTABLY NEED TO REPAY INDEBTEDNESS; AND THE FACT THAT OIL IS A WASTING ASSET, ARGUE FOR NOT ADJUSTING FULLY, BUT RATHER MAINTAINING A SMALL SURPLUS ON CURRENT ACCOUNT.

5. WP-3 SET ITS NEXT MEETING FOR FEBRUARY 15 - 16
(UNLINKED FROM EPC). END SUMMARY

INTRODUCTION

6. WP-3 OPENED WITH A REVIEW BY SECRETARIAT (FAY) OF THE EPC DISCUSSION ON NOVEMBER 21-22 (REFTEL A). THIS STATEMENT FOCUSED ON THE WEAK OUTLOOK FOR GROWTH, EXPECTATION THAT MAJOR PAYMENTS IMBALANCES WILL PERSIST IN 1978, AND THE IMPLICATIONS FOR POLICY AND EXCHANGE MARKETS.

7. WP-3 CHAIRMAN (MATSUKAWA) SOUGHT TO BALANCE FAY'S ACCOUNT, SAYING THAT THE SECRETARIAT OUTLOOK IS PESSIMISTIC. HE NOTED PROGRESS OF STABILIZATION PROGRAMS (AND BALANCE OF PAYMENTS IMPROVEMENTS) IN UK, ITALY AND FRANCE; US ENERGY POLICY INITIATIVE; AND RECENT JAPANESE AND GERMAN ECONOMIC STIMULUS MEASURES, AS FAVORABLE DEVELOPMENTS. HE MENTIONED A NEED TO RESTORE ORDERLY EXCHANGE MARKET CONDITIONS.

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USOECD; USEEC

ROLE OF U.S. DEFICIT IN GLOBAL PAYMENTS PATTERN

8. US DELEGATE (ASSISTANT SECRETARY BERGSTEN) COVERED THREE TOPICS -- THE GLOBAL OUTLOOK, US CURRENT ACCOUNT DEVELOPMENTS, AND THE FINANCING OF THE US DEFICIT. ON THE WORLD OUTLOOK, HE CITED THE FAVORABLE DEVELOPMENTS MENTIONED BY MATSUKAWA, ADDING BRAZIL AND MEXICO. ARGUED THAT MAJOR PAYMENTS IMBALANCES

REMAIN, BUT THAT EXCHANGE RATE CHANGES TO DATE SHOULD
HELP ADJUSTMENT IN 1978.

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9. ON US POSITION, BERGSTEN NOTED THAT SWING IN TRADE
BALANCE IN 1977 WAS ROUGHLY ONE-THIRD EACH WITH OPEC,
LDC'S, AND OECD COUNTRIES. THUS, WE HAVE PROVIDED
STIMULUS TO OTHERS. HE NOTED US OIL IMPORTS AND
GROWTH RATE DIFFERENTIAL BETWEEN US ECONOMY AND
OTHERS AS MAJOR CAUSES OF EXPANDED DEFICIT. WE SEE NO
CHANGE IN BASIC US COMPETITIVE POSITION. WE CAN'T
DO ANYTHING ABOUT GROWTH DIFFERENTIAL -- THAT IS UP TO
OTHERS TO REMEDY -- BUT ENERGY POLICY IS CRITICAL.
EVERY ONE MILLION BARRELS PER DAY OF REDUCED OIL IMPORTS
SAVES \$5 BILLION. ON THE OUTLOOK BERGSTEN SAID THAT
THE TRADE BALANCE DETERIORATION HAS ALREADY BEEN
ARRESTED. THUS NO FURTHER DECLINE, BUT LITTLE CHANGE
IN LEVEL IS FORESEEN FOR 1978.

10. BERGSTEN ARGUED THAT THE FINANCING OF THE US
DEFICIT WAS NOT "FORTUITOUS", AS THE SECRETARIAT
PAPER (CPE/WP-3(77)13) SUGGESTS, AND THAT WE WILL BE
ABLE TO CONTINUE ATTRACTING NECESSARY CAPITAL. HE
NOTED INTER ALIA THAT (A) GROWTH DIFFERENTIAL WHICH
HURTS US TRADE ACCOUNTS HELPS CAPITAL ACCOUNT SINCE
IT MAKES AMERICAN ECONOMY ATTRACTIVE TO INVESTMENT,
(B) MONETARY POLICY WILL REINFRCE THIS, AND (C)
BARRIERS TO CAPITAL INFLOWS IN OTHER MARKETS (E.G.
JAPAN) ALSO HELP TO KEEP OPEC IN THE LARGE AND OPEN US
MARKET.

11. HE WENT ON TO SAY THAT THERE MAY BE FURTHER EXCHANGE
RATE CHANGES, ESPECIALLY IF LARGE SURPLUSES PERSIST.
BUT THE LEVELLING OUT OF THE US DEFICIT, AND THE
CAPITAL ACCOUNT OUTLOOK, DO NOT SUGGEST SPECIFIC
PRESSURES ON THE DOLLAR. BERGSTEN ALSO NOTED THAT THE
DOLLAR IS THE PIVOT OF THE SYSTEM, AND TENDS TO MIRROR
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OTHER RATE CHANGES. IF OTHERS EXPECT THE DOLLAR TO GO
DOWN, HE WOULD LIKE TO HEAR WHAT COUNTRIES EXPECT
THEIR CURRENCIES TO APPRECIATE.

12. WEBER (FRG) RETORTED THAT BERGSTEN'S EMPHASIS ON
RELATIVE GROWTH RATES IS CONCEPT MORE VALID UNDE FIXED

THAN UNDER FLOATING RATES; IT ALSO IMPLIES THE WORKING OF THE "LOCOMOTIVE THEORY". HOWEVER, THE US HAS A SURPLUS VS. EC, SO THERE HAS BEEN NO "BENEFIT" TO EUROPE FROM OVERALL US DEFICIT. US DEFICIT IS LARGE COMPARED WITH GERMAN AND JAPANESE SURPLUSES AND THUS THE NEED FOR ADJUSTMENT IS LARGELY US. WEBER ADDED THAT US DEFICIT ADDS TO WORLD LIQUIDITY. HE INDICATED HE WAS REASSURED BY BERGSTEN'S CONFIDENCE IN THE DOLLAR AND EXPRESSED THE HOPE THAT NOT ONLY ENERGY POLICY, BUT ALSO MONETARY POLICY, WILL PLAY A ROLE.

13. IN REPLY TO WEBER, BERSTEN NOTED RELATIVE GROWTH STILL MATTERS EVEN WITH FLUCTUATING RATES. AGGREGATE CURRENT ACCOUNT SURPLUSES OF JAPAN, GERMANY, SWITZERLAND, AND BENELUX ROUGHLY EQUAL US DEFICIT. WE DON'T DENY US RESPONSIBILITY FOR ADJUSTMENT, ESPECIALLY IN THE ENERGY AREA, BUT ASSUEM WP-3 IS NOT CALLING ON U.S. TO CUT BACK ON GROWTH. WITH REGARD TO LIQUIDITY CREATION, THE US HAS BEEN A NET CAPITAL IMPORTER FOR THE PAST SEVERAL YEARS AND ON A TRADE-WEIGHTED BASIS THE AVERAGE EXCHANGE RATE HAS NOT CHANGED.

14. TRUMAN (US) INDICATED THAT MONETARY POLICY IS DIRECTED AT MAINTAINING PRUDENT GROWTH RATE, WITH STRONG DOLLAR INTERNALLY AND EXTERNALLY. RECENT RISE IN US INTEREST RATES IS REFLECTION OF RELATIVELY HIGH GROWTH RATE.

15. BELGIAN REP (VAN YPERSELE) NOTED THAT BERGSTEN'S STATEMENT UNDERLINES THE DILEMMA OF OTHERS; THEY WANT CONFIDENTIAL

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STRONG US GROWTH RATE AND RECOGNIZE DEFICIT IS

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USOECD; USEEC

CONSEQUENCE, BUT ARE WORRIED ABOUT DECLINING EXCHANGE
RATE OF THE DOLLAR WHICH TENDS TO AGGRAVATE MARKET
UNCERTAINTIES AND STRENGTHEN PROTECTIONIST TENDENCIES.
HE SUGGESTED THAT AT LEAST A PARTIAL CONTRIBTUION TO
SOLVING THIS DILEMMA, WITHOUT JEOPARDIZING US GROWTH,
WOULD BE HIGHER SHORT-TERM INTEREST RATES IN US.

16. GERMANY (POHL) STATED THAT US DEFICITS HELP
JAPANESE AND UK EXPORTS, BUT ALSO ARE A SOURCE OF
EXCHANGE MARKET DISTURBANCES. IF THIS CONTINUES,
WILL HURT "REAL" ECONOMY. QUESTION IS WHETHER
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US AS RICHEST COUNTRY SHOULD BE NET CAPITAL IMPORTER.
US OIL DEFICIT IS MAIN CAUSE OF OPEC SURPLUS, AND
NOT DESIRABLE OVER LONG TIME. EXCHANGE RATE CHANGES ARE
PARTLY JUSTIFIED BY UNDERLYING FACTORS, BUT HAVE BEEN
PARTLY DUE TO CAPITAL MOVEMENTS. THERE IS NO
JUSTIFICATION FOR FURTHER CHANGES IN DOLLAR-DM EXCHANGE
RATE.

17. BERGSTEN ARGUED THAT POHL'S QUESTION WHETHER THE
US SHOULD BE A NET CAPITAL IMPORTER NEED TO BE TAKEN
IN COONTEXT OF OPEC SURPLUS. WE DON'T SEEK CURRENT
DEFICIT, BUT SOME DEFICIT MAY BE APPROPRIATE. SURPLUSES
OF OTHER OECD COUNTRIES OCCUR IN A NEGATIVE SUM WORLD,
NOT A ZERO-SUM-WORLD. ALASKAN SUPPLY WOULD REDUCE
US OIL IMPORTS IN 1978 EXCEPT FOR \$2 - \$3 BILLION OF
IMPORTS FOR STOCKPILING IN ACCORDANCE WITH OUR IEA

COMMITMENT.

18. SECRETARIAT (MARRIS) FELT THAT CURRENT OUTLOOK FOR GROWTH OUTSIDE OF US AND "SPEED LIMIT" CONSTRAINTS ON EXPANSIONARY POLICIES MAKE IT LIKELY THAT CONTINUED SHORTFALLS ABROAD WILL MAKE FOR PERSISTENT US TRADE DEFICIT. FURTHERMORE, FOR FORESEEABLE FUTURE, EVEN IF EFFECTIVE ENERGY POLICY ADOPTED, LARGE US OIL BILL INEVITABLE. US CONSUMPTION IS GROWING LESS RAPIDLY THAN REST OF OECD, BUT US DOMESTIC PRODUCTION OF OIL IS DECLINING. THERE IS IMPORTANT NEED FOR US ENERGY POLICY FOR THE FUTURE, BUT IT IS "CRYING OVER SPILT MILK" TO EXPECT A FUNDAMENTAL CHANGE IN THE US ENERGY SITUATION.

19. MARRIS ASKED WHAT IS IT THAT OTHERS REALLY WANT US TO DO? HE CITED POHL'S REMARK THAT IT IS INAPPROPRIATE CONFIDENTIAL

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FOR US TO BE A NET CAPITAL IMPORTER, WHILE OTHERS HAVE SAID DOLLAR EXCHANGE RATE MOVEMENTS HAVE GONE TOO FAR IN PURCHASING POWER PARITY TERMS. DOES WP-3 WANT SLOWER GROWTH IN THE US? PRESUMABLY NOT. DOES IT WANT A DEVALUATION OF THE DOLLAR? PRESUMABLY NOT. SOME HAVE SUGGESTED AN INTEREST RATE TWIST BUT IS THIS REALLY FEASIBLE? MARRIS SAID THE SECRETARIAT THESIS IS THAT PERSISTENT US DEFICIT WILL TEND TO UNDERMINE EFFECT OF INTEREST RATE DIFFERENTIALS ON CAPITAL FLOWS AND THAT DOWNWARD PRESSURE ON THE DOLLAR WILL PROBABLY DEVELOP IF US MAINTAINS ITS GROWTH RATE. EVENTUALLY REAL ADJUSTMENT WILL HAVE TO TAKE PLACE, BUT IT WILL COME THROUGH EXCHANGE RATE EFFECTS RATHER THAN LOWERING OF US GROWTH.

20. UK (MCMAHON) SAID WORLD WORKS IN A FRAMEWORK OF OPEC SURPLUS AND US ENERGY DEFICIT - BOTH "SPILT MILK", AND WILL NOT GO AWAY QUICKLY. NOT HELPFUL TO LINK THEM. US IS TAKING ENERGY ACTION--SO WE SHOULD LOOK AT REST OF CURRENT ACCOUNT. IF ACTION DESIRED ON NON-OIL PART, WHAT IS WANTED? ONUS IS ON CRITICS. THE BENEFIT OF THE US DEFICIT IS DERIVED SOMEWHERE IN THE SYSTEM. CANNOT BELIEVE ANYBODY WANTS US TO SLOW GROWTH. DOLLAR DEPRECIATION IS NOT USEFUL AND IN FACT CRITICS OBJECT TO US DEFICIT BECAUSE OF ITS EXCHANGE RATE EFFECT. THEREFORE, OTHERS NEED TO TAKE ACTION, OR STOP POINTING FINGERS AT US.

21. MCMAHON WENT ON TO NOTE A NEED TO DEAL WITH CROSS-RATE CHANGES. PERHAPS GREATER LONG-TERM CAPITAL FLOWS FROM SURPLUS COUNTRIES WOULD HELP. GERMANS ARE MAKING

PROGRESS IN THIS DIRECTION, BUT HOW ABOUT JAPAN? BUT
THERE REMAINS PROBLEM OF LARGE MOVEMENTS IN CORSS RATES.
ARE THE AMERICANS ACCEPTING THEIR RESPONSIBILITIES AS
RESERVE CURRENCY COUNTRY? AGAIN, THE QUESTION GOES TO
MORE THAN JUST THE US. GIVEN THE US SITUATION,
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WOULD THE RESERVE CURRENCY RESPONSIBILITY BE SHARED?
WE NEED TO ANSWER THIS IF INSTABILITY IS TO BE HANDLED.

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USOECD; USEEC

22. COUZENS (UK) DID NOT WANT U.S. TO REDUCE GROWTH
TO RUDUCE DEFICIT. NOTED ALL WANT US TO REDUCE OIL
IMPORTS BUT RECOGNIZE THIS TAKES TIME. HE AGREED WITH

EFFECT OF GROWTH DIFFERENTIAL FACTOR ON US DEFICIT.
HE WAS WORRIED THIS WILL NOT CHANGE SOON; GROWTH ABROAD
IS LOOKING LOWER, NOT CATCHING UP. THIS MEANS RISING
UNEMPLOYMENT IN EUROPE, AT LEAST FOR THE FIRST HALF
OF 1978. US CUTBACK IN GROWTH MIGHT RESULT.
ALTERNATIVE IS CONTINUING EXCHANGE RATE MOVEMENT DUE TO
PERSISTENT PAYMENTS IMBALANCES AND BECAUSE OF SO MUCH
LIQUIDITY. IN REFERRING TO THE RECENT UK EXPERIENCE
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WITH STERLING, COUZENS NOTED SOME POSSIBLE OVERSHOOTING,
AND SUGGESTED WP-3 LOOK INTO "HELPFUL" VS. "UNHELPFUL"
EXCHANGE RATE MOVEMENTS.

23. LANGUETIN (SWISS) ASKED ABOUT EXCHANGE RATE
STABILITY, QUESTIONING THE STATEMENT OF NO CHANGE IN
THE COMPETITIVE POSITION OF US. IF THIS TRUE,
PROTECTIONIST THREATS MAY NOT BE JUSTIFIED; ALSO,
FURTHER DEPRECIATION NOT NEEDED. HE ALSO STRESSED ENERGY
PROGRAM AS CONTRIBUTING TO RATE STABILITY. LANGUETIN
WENT ON TO ARGUE THAT IF US HAS HAD NO FINANCING
DIFFICULTIES, IT IS BECAUSE OTHER CENTRAL BANKS
HAVE BEEN "FORCED" TO INTERVENE TO SUPPORT THE DOLLAR,
CONTRARY TO EXPECTATION UNDER FLOATING RATES. THE
SYSTEM DOES NOT CONTRIBUTE TO GREATER RATE STABILITY;
IS THE SYSTEM OPERATING RIGHT? HE SAID THE SWISS WANT
ONLY A "REGULAR", NOT FIXED, EXCHANGE RATE REGIME.

24. DUTCH (KESSLER) NOTED THAT FINANCING IS CRUCIAL.
FINANCING GETS DONE EX POST -- THE NEED IS TO FIND WILLING
HOLDERS OF DOLLARS AT SOME "ACCEPTABLE" EXCHANGE RATE.
WHAT IS SUCH "ACCEPTABLE" RATE? HE WOULD AGREE NOT
DESIRABLE FOR US TO LOWER GROWTH RATE. IF GROWTH RATE
DIVERGENCES PERSIST, AGREE NEED FOR CONTINUED US
COMPETITIVENESS VIA EXCHANGE RATE CHANGES. BUT THIS NOT
YET NEEDED. POLICY MEASURE ON ALL SIDES SHOULD BE
TAKEN. THE WORLD SHOULD KNOW THAT US CARES ENOUGH
ABOUT DOLLAR THAT IT WILL USE SHORT-TERM RATES TO
CONTROL OUTFLOWS.

25. GERMANY (POHL) WAS UNWILLING TO ACCEPT US OIL
DEFICIT AS A "FACT OF LIFE" A LA MARRIS AND MCMAHON.
THIS ACCOUNTS FOR \$20 BILLION OF OPEC SURPLUS. HE
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ARGUED THAT OPEC WILL NOT BE SATISFIED TO BUILD UP

FINANCIAL ASSETS FOREVER. POHL AGREED THAT RESPONSIBILITY SHOULD BE SHARED, AND ACKNOWLEDGED THE GERMAN GROWTH SHORTFALL. ON THE MONETARY SIDE HE NOTED UK EXCHANGE MARKET INTERVENTION, AND POINTED TO CENTRAL BANK BUILD-UP OF RESERVES (\$25 BILLION SO FAR THIS YEAR), WHICH MAKES FOR LATE 1960'S ENVIRONMENT WHICH TOUCHED OFF 1970'S INFLATION. HE ALSO REFERRED TO "BILATERAL" US-JAPAN PROBLEM.

26. FRANCE (DE LAROSIERE) SAID WE NEED TO DEAL WITH THREE KINDS OF NON-OPEC PROBLEMS: (A) US ENERGY POLICY IS AT CENTER OF DEBATE; REDUCED US OIL IMPORTS WOULD REDUCE PRICE PRESSURE AND EXPANSION OF INTERNATIONAL LIQUIDITY AS WELL AS US DEFICIT. HE SUPPORTED US ENERGY EFFORTS; (B) ADDITIONAL DOMESTIC STIMULUS IS NEEDED IN SURPLUS COUNTRIES; (C) MORE ACTION NEEDED FOR BALANCE OF PAYMENTS SUPPORT AND FINANCE; WE MUST LOOK AT ADJUSTMENT POTENTIAL IN LDC'S AND SMALLER OECD COUNTRIES. THIS RAISES ISSUE OF CONDITIONALITY.

26. DE LAROSIERE WENT ON TO NOTE THREE THINGS TO AVOID: (A) RELIANCE ON TOO RAPID REAL EXCHANGE RATE ADJUSTMENT COULD LEAD TO RECESSION AND PROTECTIONISM; (B) EXCESSIVE EMPHASIS ON THE US DEFICIT, WHICH IS PRESENTLY A GIVEN (AND HELPS) COULD TALK DOWN THE DOLLAR; AND (C) DOGMATIC POSITIONS ON EXCHANGE RATES OR FINANCING PATTERNS.

27. CANADA (JUBINVILLE) ASKED WHETHER US AND OTHER PUBLIC OPINION IS LIKELY TO BE AS PATIENT AS THE EPC DISCUSSION MIGHT SUGGEST? IS THERE NOT RISK OF RESTRICTIVE B/P MEASURES BEGINNING IN THE US?

28. BERGSTEN AGREED THAT CANADIAN QUESTION RAISED
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CENTRAL ISSUE. THIS IS WHY WE ARE CONCERNED WITH OUR DEFICIT AND TAKING THOSE ACTIONS WITHIN OUR OWN POWER.

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PROTECTIONIST PRESSURES COULD BE PUSHED PAST CRITICAL POINT, PARTICULARLY IF SURPLUSES BY TRADING PARTNERS PERSIST. THIS IS MAJOR REASON FOR OUR STRIDENCY -- WE SEE CONGRESS, LABOR, ETC. SOUNDING MOE PROTECTIONIST AND TREATENING INTERNATIONAL ECONOMIC REGIME. WE HAVE REVIEWED ALL POSSIBLE MEASURES AND DECIDED RESPONSIBLE COURSE IS: (A) MAJOR, COMPLETE ENERGY PROGRAM; (B) MAINTAINING COMPETITIVE POSITION AND (C) CONTINUE DIFFERENTIAL DEMAND MANAGEMENT STRATEGY. WE WANT TO AVOID PRECIPITATE ACTION BECAUSE CURE IS WORSE THAN THE DISEASE. WE HAVE CONSIDERED, AND REJECTED, SUCH CONFIDENTIAL

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ACTION -- BUT PUBLIC OPINION NEEDS A CREDIBLE PROGRAM.

28. BERGSTEN SAID WE TAKE VERY SERIOUSLY OUR OBLIGATION AS KEY CURRENCY COUNTRY -- WE RECOGNIZE THE NEED FOR A STABLE, GROWING ECONOMY AND AN EFFECTIVE ENERGY PROGRAM. THE US SHARES CONCERN TO MINIMIZE INSTABILITY, FOR EXAMPLE, SUPPORTING IMF SURVEILLANCE ROLE, BUT IT IS NOT CLEAR THAT BUILDUP OF OFFICIAL HOLDINGS HAS BEEN A "UNIQUE" SOURCE OF FINANCING. MOST

PROBABLY PRIVATE FLOWS WOULD HAVE BEEN FORTHCOMING IF AUTHORITIES HAD NOT INTERVENED. WE AGREE TRADE DEFICIT DOES NOT REQUIRE DOLLAR DEPRECIATION. BERGSTEN REFERRED TO SECRETARY BLUMENTHAL'S HOUSTON SPEECH WHICH GIVES A DEFINITIVE STATEMENT OF OUR POLICY ON THIS.

GERMANY

29. FRG (WEBER) POINTED TO SUBSTANTIAL DECLINE IN THE GERMAN CURRENT ACCOUNT SURPLUS THIS YEAR (WHICH HE EXPECTED TO BE LESS THAN \$2 BILLION COMPARED WITH THE SECRETARIAT'S FORECAST OF \$3-1/2). WHILE NOTING SPECIAL INFLUENCES ON INVISIBLES, HE NOTED ALSO THE EFFECT OF EXCHANGE RATE CHANGE ON GERMANY'S COMPETITIVE POSITION. POHL ADDED GERMANY'S 1977 CURRENT SURPLUS WILL BE LESS THAN 1 PERCENT OF GNP AND THAT WITH LONG-TERM CAPITAL EXPORTS OF SOME \$11 BILLION, GERMANY'S BASIC BALANCE IS IN DEFICIT. WEBER POINTEDLY REMARKED THAT GIVEN THESE TRENDS IN GERMANY'S EXTERNAL POSITION GERMANY AND JAPAN SHOULD NOT BE CONSIDERED IN THE SAME CATEGORY.

30. WEBER WENT ON TO STATE THAT THERE ARE NO POLICY
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CONSTRAINTS ON A STRONG GERMAN EXPANSION -- THE ONLY BARRIERS ARE PSYCHOLOGICAL. FURTHER STIMULATIVE ACTION COULD PREJUDICE RESULTS OF THE UPCOMING WAGE ROUND. THE FRG WILL NOT BE AN EFFECTIVE "LOCOMOTIVE".

31. SWEDEN (WOHLIN) ASKED WHAT ADVISE THE FRG WOULD GIVE DEFICIT COUNTRIES. THEY HAVE TO DEVALUE IF SURPLUSES DO NOT COME DOWN; SWEDEN HAS, AND ALSO HAS DEFLATED. SHOULD ALL DEFICIT COUNTRIES LOWER GROWTH RATES? THE ALTERNATIVE IS UPWARD PRESSURE ON STRONG CURRENCIES.

32. WEBER RESPONDED THAT THE GERMANS USUALLY REFRAIN FROM ADVISING OTHERS. THE AUTHORITIES HAVE A "TRANQUIL MIND", THOUGH THE PROBLEM IS A SERIOUS ONE. IN RESPONSE TO A QUESTION FROM IZZO (ITALY) HE ACKNOWLEDGED THAT NO ACTION HAS BEEN TAKEN TO OFFSET DEFLATIONARY EFFECTS OF DM APPRECIATION, SINCE "ALL HAS BEEN DONE".

JAPAN

33. JAPAN (HIRAO) BEGAN BY NOTING THAT NEARLY 80 PERCENT OF JAPANESE EXPORT INCREASE IN 1977 WAS DUE TO PRICE RISES, WHILE EXPORT VOLUME HAS BEEN FALLING FOR

LAST THREE MONTHS. HE WENT ON TO ARGUE THAT VOLUME, NOT DOLLAR VALUE, IS THE RELEVANT DINDICATOR OF EFFECTS ON INCOME AND EMPLOYMENT ABROAD. JAPANESE EXPORT INDUSTRIES, EXPECIALLY SMALL-SCALE ONES, ARE ALREADY AFFECTED. IN ADDITION, THE JAPANESE HAVE PROMOTED LONG-TERM CAPITAL OUTFLOWS. HE WENT ON TO STATE THAT THE LONG-TERM PRICE ELASTICITY OF DEMAND FOR JAPANESE EXPORTS IS 1.2 - 1.5, SO RECENT YEN APPRECIATION WILL START TO BITE NEXT YEAR. CURRENT ACCOUNT SRUPLUS IN 1978 WILL BE DOWN FROM THIS YEAR'S NEARLY \$10 BILLION, BECAUSE OF LOWER MARKET GROWTH ABROAD;
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EFFECTS OF YEN APPRECIATION; AND EFFECTS OF DOMESTIC STIMULUS AND IMPORT FACILITATING MEASURES.

34. HIRAO ALSO INDICATED THAT FURTHER IMPORT PROMOTING MEASURES ARE CONTEMPLATED. TURNING TO THE GOVERNMENT DEFICIT, HIRAO NOTED THAT HIGH DEFICIT (30 PERCENT OF EXPENDITURES) ONLY JUSTIFIABLE IF THERE IS

REASONABLE PROSPECT FOR HIGHER GROWTH, AND RESULTING HIGHER TAX REVENUE AND THUS A LOWER DEFICIT, LATER. OTHERWISE, INCREASE IN GOVERNMENT BONDS WOULD EVENTUALLY "FLOOD THE MARKET".

35. JAPAN (SHIMAMOTO) NOTED THAT YEN APPRECIATION HAD UNDERMINED INVESTOR CONFIDENCE, AND THUS DOMESTIC ACTIVITY. IN RESPONSE TO "VOLATILE, SHORT-TERM CAPITAL FLOWS" BARRIERS TO FOREIGN PURCHASES OF TREASURY BILLS HAVE BEEN INSTITUTED AND FULLY OFFSETTING INTERVENTION CARRIED OUT.

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ACTION EUR-12

INFO OCT-01 EA-10 ISO-00 AID-05 CEA-01 CIAE-00 COME-00
EB-08 FRB-03 INR-07 IO-13 NEA-10 NSAE-00 USIA-06
OPIC-03 SP-02 TRSE-00 LAB-04 SIL-01 AGRE-00
OMB-01 SS-15 DODE-00 PM-05 H-01 L-03 NSC-05

PA-01 PRS-01 AF-10 ARA-10 FEA-01 STR-05 ABF-01

FS-01 OIC-02 /148 W

-----025482 020257Z /63

R 011854Z DEC 77

FM AMEMBASSY PARIS

TO SECSTATE WASHDC 2481

INFO AMEMBASSY BERN

AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY THE HAGUE

AMEMBASSY LONDON

AMEMBASSY OTTAWA

AMEMBASSY ROME

AMEMBASSY STOCKHOLM

AMEMBASSY TOKYO

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USOECD; USEEC

36. SECRETARIAT (FAY) NOTED THAT THE JAPANESE EXPORT PROJECTION IMPLIED AN EVEN LOWER MARKET GROWTH THAN SECRETARIAT'S RATHER PRESSIMISTIC FORECAST. HE ALSO DISPUTED THE ARGUMENTS THAT EXPORT VOLUME IS THE BEST INDICATOR OF EFFECTS ON FOREIGN MARKETS OR THAT THE BASIC BALANCE SHOULD BE STRESSED. HE POINTED OUT THAT THE U.S. AND OPEC BALANCES ARE "STUCK" IN THE SHORT TERM, SO ANY ADJUSTMENT MUST COME FROM OTHER OECD SURPLUS COUNTRIES.

37. SECRETARIAT (MARRIS) MADE POINT THAT JAPAN'S
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PROBLEM IS THE OPPOSITE OF THE U.S. -- ITS GROWTH IS RELATIVELY SLOWER, NOT FASTER. GIVEN LOW JAPANESE IMPORT PROPENSITY, THIS RESULTS IN A STRUCTURAL SURPLUS UNTIL EXPORT GROWTH SLOWS QUITE DRAMATICALLY. THE SECRETARIAT SUGGESTS DOMESTIC STIMULUS, TO INCREASE IMPORTS, AS LESS PAINFUL THAN THE ALTERNATIVES OF FURTHER YEN APPRECIATION OR PROTECTIONIST MEASURES AIMED AT JAPAN.

38. MATSUKAWA NOTED THAT THIS TRADE-OFF WAS CONSIDERED IN SEPT, WHEN THE 6 PERCENT GROWTH RATE WAS CHOSEN AS THE BEST COMPROMISE. BUT THEN THE YEN WAS AT 260 TO DOLLAR. IN THEORY, THE OPTIMAL GROWTH RATE SHOULD NOW BE RECONSIDERED.

39. FRG (FLANNDORFER) NOTED EFFECT OF IMPORT CON-
POSITION ON ELASTICITIES, AND EXPRESSED DOUBT THAT

JAPANESE IMPORTS COULD CHANGE VERY QUICKLY.

40. U.K. (COUZENS) POINTED OUT THAT THE CURRENT REALITIES WILL FORCE THE JAPANESE ECONOMY TOWARD A MORE WESTERN PATTERN -- I.E., LOWER SAVINGS, CHANGED OUTPUT AND TRADE COMPOSITION. IN THE MEANTIME, HIGH SAVINGS RATE MIGHT MAKE A LARGER GOVERNMENTAL DEFICIT POSSIBLE AND PERHAPS TAX RELIEF FOR CONSUMERS COULD BE CONSIDERED. HIRAO REPLIED THAT TAX REVISION, FOR TAX STRUCTURE REASONS, WAS UNDER CONSIDERATION (TO INCREASE CONSUMPTION TAXES).

4. COUZENS EXPRESSED DISBELIEF AS THE DISCUSSION ON JAPAN ENDED.

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42. COUZENS SATED THAT THE U.K. WILL OBSERVE THE OBLIGATION UNDER THE IMF STANDBY EVEN THOUGH THE LAST DRAWING NOT MADE. THE DECISION TO LET STERLING RATE GO WAS IN ORDER TO RETAIN MONETARY CONTROL. IN VIEW OF THE EXPECTED SURPLUS NEXT YEAR, BERGSTEN ASKED IF THE U.K. HAS A TARGET FOR ITS CURRENT ACCOUNT. HE NOTED THE LARGE SCALE DEBT, AND THE CONTINUING CONTROLS ON CAPITAL OUTFLOWS. COUZENS RESPONDED THAT THERE IS A "GREAT DEBATE" NOW ON HOW TO USE NORTH SEA BENEFITS. THE NEED FOR SOME DEBT REPAYMENT, AND THE VIEW THAT CONSUMPTION SHOULDN'T BE FULLY ADJUSTED TO PROCEEDS OF SALE OF A WASTING ASSET, BOTH ARGUE FOR A SMALL SURPLUS.

FRANCE

43. DE LAROSIERE SAID THAT THE 1977 FRENCH CURRENT ACCOUNT IS EXPECTED TO BE IN DEFICIT BY 13 BILLION FRANCS, OR LESS THAN \$3 BILLION. THIS "RELATIVELY SATISFACTORY" RESULT IS DUE TO LOWER REAL GROWTH, NO DROUGHT, AND A SERVICES SURPLUS EXPECTED TO DOUBLE (TO \$2 BILLION). THE HOPE IS FOR A \$1-1/2 BILLION SURPLUS NEXT YEAR (IMPORTS AND EXPORTS UP 7 AND 8 PERCENT RESPECTIVELY) BUT THIS ON ASSUMPTION OF 4-1/2 PERCENT GNP GROWTH ABROAD.

PROCEDURAL MATTERS

44. SECRETARIAT (DOBELL) RECALLED THAT WP-3 MEMBERS HAD BEEN ASKED FOR COMMENTS ON THE SUGGESTED WORK PROGRAM CONTAINED IN DOCUMENT CPE/WP3(77)8. SOME

COMMENTS HAD BEEN RECEIVED. ON THIS BASIS THE NEXT MEETING OF WP-3 MIGHT BEGIN TO EXAMINE CHANGES IN COMPETITIVE POSITIONS AND IN TRADE PRICING, AS WELL AS THE BOUNDARY CONDITIONS EXTERNAL TO THE OECD AREA, CONFIDENTIAL

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PRELIMINARY TO AN EFFORT TO STUDY (A) THE ROLE OF EXCHANGE RATES AS AN INSTRUMENT OF ADJUSTMENT AND (B) THE RELATIVE IMPACT OF EXCHANGE RATES AND DEMAND MANAGEMENT POLICIES ON COMPETITIVE POSITIONS.

45. DOBELL NOTED THAT, SINCE EPC'S WP-2 IS ENGAGED IN CONSTRUCTION "MEDIUM-TERM" GROWTH SCENARIO TO 1985, IT WOULD BE LOGICAL FOR WP-3 TO EXAMINE EXTERNAL CONSISTENCY AND IMPLICATIONS OF RESULTS OF THIS GROWTH SCENARIO WHEN WP-2'S WORK HAS REACHED APPROPRIATE POINT.

46. MATSUKAWA INDICATED THAT WP-3 WILL HAVE FURTHER OPPORTUNITY TO DISCUSS THE WORK PROGRAM AT ITS NEXT MEETING.

47. NEXT MEETING OF WP-3 WAS SCHEDULED FOR FEB 15 AND FEB 16 (HALF DAY) UNLINKED FROM EPC. SALZMAN

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Message Attributes

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Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: MEETINGS
Control Number: n/a
Copy: SINGLE
Sent Date: 01-Dec-1977 12:00:00 am
Decaption Date: 01-Jan-1960 12:00:00 am
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 22 May 2009
Disposition Event:
Disposition History: n/a
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Executive Order: GS
Errors: N/A
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SAS ID: 112643
Secure: OPEN
Status: NATIVE
Subject: WORKING PARTY 3 OF EPC MEETING OF NOVEMBER 23
TAGS: EFIN, ECON, CA, FR, GE, IT, JA, NL, SW, SZ, UK, OECD, EPC
To: STATE BERN
Type: TE
vdkgvwkey: odbc://SAS/SAS.dbo.SAS_Docs/3cf3cefb-c188-dd11-92da-001cc4696bcc
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